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Taxation and Revenue Department

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FACSIMILE TRANSMITTAL COVER SHEET

TO: MINERALS MANAGEMENT SERVICE

ATTENTION: DAVID GUZY

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FROM: Valdean Severson

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CERTIFIED MAIL ♦ RETURN RECEIPT REQUESTED

March 19, 1998

Mr. David S. Guzy, Chief
Rules and Publication Staff
Minerals Management Service
P.O. Box 25165 - MS 3101
Denver, Colorado 80225

Dear Mr. Guzy:

The New Mexico Taxation and Revenue Department (Department) submits the following comments as it relates to the Federal Register Notice dated February 6, 1998:

First and foremost, the Minerals Management Service (MMS) should be commended for the effort they have made in developing oil valuation regulations that are fair to all interested parties. They also should be commended for recognizing an issue and following through with it to resolution, in an environment where litigation abounds, unfounded criticism is made public and political mechanisms are used to mandate positions.

What is being presented as a proposal is a significant change from what was previously presented in Federal Register Notices. It is clear from the proposal that MMS has listened to the issues and concerns and has made noticeable changes.

The following specific comments relate to areas where MMS requested input or where changes/clarifications are warranted to support the intent and understanding of the proposal.

Section 206.101: Definitions

- The Department is strongly opposed to including the San Juan Basin in New Mexico as part of the Rocky Mountain Area when applying the proposed regulations. Our reviews clearly show that this Basin is not isolated from the Midland market center. Multiple examples can be identified where major producers are arranging buy/sell contracts for production in the Basin and receiving back similar-type product in the Midland market.
- Additional definitions should be added to support regulatory position as it relates to terms such as "overall balances" and "cooperative ventures".

Section 206.103(b): Criteria Two

- MMS should reconsider the position as it relates to not recognizing quality as a comparable when deriving volume-weighted average gross proceeds. Significant price differentials exist between sweet and sour and their related gravity factors, and these value differentials should be recognized as part of the basis for lease valuation.

- Page 6122, third column, sixteenth line identifies Section 205.103, and it should be Section 206.103.

Section 206.110(b)(1)

- The last sentence should be deleted because it appears that MMS may approve an allowance for transporting lease production which is not royalty-bearing. The Department questions the basis where this might be approved, and it opens Pandora's box for requests as it relates to non-royalty-bearing products in a natural gas stream.

Section 206.112(a)

- This paragraph does not appear to recognize a situation where an arm's-length exchange agreement exists between the lease and aggregation point. An adjustment to the index price should be recognized the same as what is identified in the paragraph.

Section 206.113

- Paragraphs (a), (b), (c) and (d) are too complex as written.
- In paragraph (a) the words "dispose of" are incorrectly used and should be replaced with the words "account for".
- Paragraph (a) makes reference to Section 206.112 (c) and (e). This reference is incorrect if the production is accounted for through exchanges to the market center.
- Paragraph (b) uses the term "moves lease production". Clarification is needed as to the meaning.
- Paragraph (c) uses the term "moves your oil directly". Clarification is needed as to the meaning.
- Paragraph (a) refers to paragraph (d) of subject section (non-arm's-length exchanges), but paragraph (d) refers you back to paragraphs (a), (b) and (c).

Based on the above comments, the Department highly recommends that Section 206.113 be rewritten. Additional paragraphs explaining each specific transaction set would be helpful in outlining the requirements. Section 206.113 is one of the most critical elements of the regulations, and as such, the Section must clearly identify and explain the requirements as it relates to recognizing differentials and actual transportation costs.

Section 206.119

- Based on the Departments's experience reviewing exchange contracts at the aggregation points and market centers, no reporting company will be able to define only federal oil. If the requirements are not changed to identify all exchanged oil, MMS will not be receiving forms or will be receiving erroneous data elements on such submitted forms.

Form MMS-4415

- In Section 206.112(b)(2), it states that MMS will publish annually a series of differentials based on data collected on subject form, and the differentials will be for similar-quality types (for example, sweet vs sour). However, in reviewing the form, no requirement exists to identify quality type.
- Part 2, "Contract Type and Identification", instructions are unclear on how the "Contract #" will be linked. Each company that is part of an exchange agreement will have their own distinct contract number. Unless MMS receives both contract numbers from each reporting company, no links can be made.
- Part 3, "Contract Term" instructions are unclear on how a contract is to be identified in a new reporting cycle, if it was amended during the previous reporting cycle.
- Part 7, "Quality Information and Adjustments" can be different from contract to contract, and it is unclear from Section 206.112(b)(2) on how MMS will apply such in the calculations.

In concluding, the Department requests that MMS move forward in promulgating this proposal. Based on the proposal as drafted, the Department feels that royalty payors that sell arm's-length at or off the lease are not impacted, and royalty payors which sell their production through a marketer, or recognize such as refinery stock, are now mandated to pay federal royalties on a fair market-driven price that is not controlled by them through a posting mechanism.

Sincerely,

John Chavez, Secretary
New Mexico Taxation and Revenue Department